

## Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 ICAE-00 NSCE-00 SSO-00 AID-05  
CIAE-00 COME-00 EB-08 FRB-03 INR-10 NSAE-00  
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SS-15 STR-07 CEA-01 L-03 H-01 PA-01 AGRE-00  
DOE-15 SOE-02 DOEE-00 INRE-00 /095 W  
-----123965 211018Z /15

O 210925Z APR 78  
FM AMEMBASSY TEL AVIV  
TO SECSTATE WASHDC IMMEDIATE 2726  
INFO AMCONSUL JERUSALEM IMMEDIATE  
INFO AMEMBASSY CAIRO  
AMEMBASSY AMMAN  
AMEMBASSY DAMASCUS  
AMEMBASSY JIDDA

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E.O. 11652: N/A  
TAGS: EFIN, ELAB, IS  
SUBJECT: ECONOMIC IMPLICATIONS OF THE EHRLICH-MESHEL AGREEMENT

REF: 77 TEL AVIV 10198, TEL AVIV 3690

1. SUMMARY. FINANCE MINISTER EHRLICH AND HISTADRUT SECRETARY GENERAL MESHEL SIGNED AGREEMENT APRIL 19 CALLING FOR A FREEZE ON TAXES AND ON PRICES OF BASIC GOODS AND SERVICES. OUR PRELIMINARY EXAMINATION OF THE ECONOMIC IMPLICATIONS OF THE AGREEMENT LEADS US TO CONCLUDE THAT THE GOI WILL HAVE TO SUBMIT A SUPPLEMENTAL BUDGET OR REDRAFT ITS ORIGINAL BUDGET. OTHERWISE IT FACES HIGHER PRIVATE AND PUBLIC CONSUMPTION, LOWER INVESTMENT, HIGHER IMPORTS AND LOWER EXPORTS. END SUMMARY.

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2. IN WHAT THEY CALLED A "PASSEOVER EVE HOLIDAY PRESENT TO THE NATION," FINANCE MINISTER EHRLICH AND HISTADRUT SECRETARY YERUHAM MESHEL SIGNED AN AGREEMENT PROVIDING FOR A SIX MONTH FREEZE ON DIRECT AND INDIRECT TAXES AND ON PRICES OF BASIC GOODS AND SERVICES WHICH ARE SET BY THE GOVERNMENT (DETAILS REPORTED SEPTTEL). IN RETURN THE HISTADRUT WILL HELP KEEP A 15 PERCENT LID

ON PUBLIC SECTOR WAGE INCREASES.

3. THE DIRECT COST OF THE AGREEMENT IS ESTIMATED AT IL 7 TO 8 BILLION. THE SUBSIDIES NECESSARY TO FINANCE THE PRICE FREEZE WILL ADD ANOTHER IL 3 BILLION TO THE BUDGET, WHILE A 15 PERCENT WAGE BOOST IN THE PUBLIC SECTOR COULD WELL ADD ANOTHER IL 5 BILLION TO GOVERNMENT OUTLAYS.

4. SINCE THE AGREEMENT ALSO LINKED TAX BRACKETS 100 PERCENT TO THE COST OF LIVING INDEX, THERE WILL NOT BE A SIGNIFICANT REVENUE GAIN TO THE GOVERNMENT FROM HIGHER INCOME TAX COLLECTION AT PROGRESSIVE RATES. THE MAIN OFFSET WILL BE IN THE COLLECTION OF ADDITIONAL VALUE-ADDED TAX FROM INCREASED PURCHASES OF PRICE-CONTROLLED COMMODITIES, BUT MOF SOURCES ESTIMATE THIS ADDITIONAL INCOME AT LESS THAN IL 1 BILLION. THE MOF HAS LITTLE LEEWAY IN ABSORBING THESE EXPENDITURES WITHIN THE PRESENT BUDGET BY REDUCING OTHER ALLOCATIONS, SINCE ALMOST TWO THIRDS OF THE BUDGET IS COMMITTED TO THE UNTOUCHABLE AREAS OF DEFENSE AND DEBT REPAYMENT. TAKING THE BUDGET CHANGES INTO ACCOUNT, WE TEND TO AGREE WITH THE MOF ANALYST WHO ESTIMATED THE BUDGET DEFICIT AT IL 15 BILLION IF THE PRESENT FRAMEWORK IS MAINTAINED AND THE NEW OUTLAYS ADDED ON. SINCE THE BUDGET DEFICIT IS FINANCED BY DIRECT BORROWING LIMITED OFFICIAL USE

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FROM THE BANK OF ISRAEL, THERE IS LITTLE THE BOI CAN DO IN THE WAY OF MONETARY POLICY TO OFFSET THE EXPANSIVE BUDGETARY POLICY THAT NOW APPEARS IN STORE. IF IT TRIES TO IMPOSE A TIGHTER MONETARY POLICY THROUGH HIGH RESERVE REQUIREMENTS OR BOOSTING INTEREST RATES, IT RUNS THE DANGER OF ABORTING THE PRIVATE SECTOR RECOVERY THAT IS SUPPOSED TO BE THE FOUNDATION OF ECONOMIC GROWTH IN COMING YEARS.

6. INSOFAR AS ISRAELI INFLATION IS BASICALLY OF THE COST-PUSH VARIETY, THE AGREEMENT COULD MODERATE THE PACE OF INFLATION IN COMING MONTHS. THE GOVERNMENT MAY IN FACT HAVE TO PAY OUT LESS THAN THE 10 PCT C-O-L ALLOWANCE PAYMENT IT HAS BUDGETED FOR OCTOBER. HOWEVER, THE SHARPLY INCREASED BUDGET DEFICIT POSES THE DANGER THAT A DEMAND-PULL INFLATION MAY RESULT IN THE MEDIUM TERM.

7. INCREASED DEMAND WILL ALSO HAVE ITS EFFECT ON MACROECONOMIC AGGREGATES. UNLESS THE GOI CAN TAKE COUNTERACTING MEASURE, , MEDIUM TERM PROSPECTS ARE FOR HIGHER PRIVATE AND PUBLIC CONSUMPTION, LOWER INVEST-

MENT, HIGHER IMPORTS AND LOWER EXPORTS.

8. THE ORIGINAL FY 78 BUDGET EXPENDITURE FIGURE WAS DELIBERATELY UNDERSTATED BY THE FINANCE MINISTRY TO FORESTALL INFLATIONARY EXPECTATIONS AND HOLD WAGE DEMANDS DOWN. MANY OTHER ASSUMPTIONS OF THE BUDGET, IN ADDITION TO THE ZERO-GROWTH IN PUBLIC SECTOR WAGES, HAVE GONE BY THE BOARDS, SO WE WOULD NOT BE TOO SURPRISED TO SEE A SUPPLEMENTAL BUDGET PROPOSAL IN THE NEAR FUTURE. SUCH A PROPOSAL OR EVEN A REWORK OF THE ORIGINAL BUDGET IS CLEARLY NEEDED.

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 jan 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
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**Copy:** SINGLE  
**Draft Date:** 21 apr 1978  
**Decaption Date:** 01 jan 1960  
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**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 20 Mar 2014  
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**Disposition History:** n/a  
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